

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: MAY 3, 2000

Contact Person:

ID Number:

Telephone Number:

NO PRIVATE FOUNDATION
Release copies to District

Date

SURNAME

Employer Identification Number:

Dear Applicant:

We have considered your application, pursuant to Revenue Procedure 80-27, 1980-1 C.B. 677, for a group ruling recognizing exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code for fifteen (15) subordinate organizations. Each subordinate organization is separately incorporated and operates a charter school for children determined by the local school district to be at-risk, or drop-outs.

You were recognized as tax-exempt under section 501(c)(3) of the Code on [REDACTED], and as a nonprivate foundation described in sections 509(a)(1) and 170(b)(1)(A)(ii). Your Board of Directors are: [REDACTED] and [REDACTED]. [REDACTED] provides services to you and is your superintendent. [REDACTED] receives a percentage of your administrative income on a per student basis and is compensated for services provided to you. Your Articles state that board members hold office until they resign or are terminated by a majority of the board. In your application for recognition of exemption you stated that you plan to set up high-tech centers in inter city schools for at-risk and adjudicated students and dropouts, and that you operate one charter school. Your application indicated that [REDACTED] provided your curriculum. [REDACTED] - Chairman, [REDACTED] and [REDACTED] [REDACTED] and [REDACTED] are part of the [REDACTED]. There was an indication that one of your board members was under contract with [REDACTED]. Your charter application stated that the geographic area to be served is in the [REDACTED] School District.

You have stated the subordinate organizations are not private foundations as

[REDACTED]

defined in section 509(a) of the Code. All organizations have given written authorizations to be included as a subordinate organization to you. You stated that they were under your general control, but did not give specifics as to the type of control. You did not provide any information such as board meeting minutes or contracts entered into to operate the schools, manage the schools, or to provide school facilities.

The representative sample of the Articles of Incorporation you submitted state that the subordinate organizations shall implement educational concepts to enhance the learning experience of at-risk students in a charter school environment and train teachers in the implementation of innovative educational concepts. The Articles do not limit the purposes or activities to those within the meaning of section 501(c)(3) of the Code. You did not provide a copy of the bylaws used by your subordinates. The Articles do not limit board member's terms or regulate the replacement or selection of future board members. The Articles do not indicate whether there is control by you or even a relationship with you.


You stated that the subordinate organizations' Board of Directors are: [REDACTED] [REDACTED] and [REDACTED] [REDACTED] is your President. [REDACTED] is the President of each of the subordinate organizations. There was no information submitted regarding the provision of services by your board to the subordinates or by the board members of the subordinate organizations to you or to the subordinate organizations.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for educational purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. the section cross references the definition of private shareholder which is contained in section 1-501(a)-


1(c). That section provides that the words private shareholder or individual in section 501 refers to person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Situation 2 of Rev. Rul. 69-545, 1969-2 C.B. 117, describes a hospital, otherwise serving a charitable purpose, that was denied exemption under section 501(c)(3) of the Code because it served a private interest more than incidentally. The revenue ruling states that in considering whether a nonprofit organization claiming charitable exemption is operated to serve a private benefit the Service will weigh all of the relevant facts and circumstances in each case.

Rev. Proc. 80-27, 1980-2 C.B. 677, sets forth the procedures under which recognition of exemption from federal income under section 501(c) of the Code may be obtained on a group basis for subordinate organizations affiliated with and under the general supervision or control of a central organization. Section 5.01(c) of the Rev. Proc. provides that the central organization must provide a detailed description of the purpose and activities and activities of the subordinate including sources of receipts and nature of expenditure.

Rev. Proc. 90-4, 1990-2 I.R.B. 10, at section 7 provides that the Service may decline to issue a ruling or a determination letter whenever warranted by the facts or circumstances of a particular case.

Rev. Proc. 90-27, 1990-18 I.R.B. 17, provides, in part, that exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned, and the nature of contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that its proposed activities will be exempt, a record of actual operations may be required before a ruling or a determination letter will be issued. In those cases where an organization is

[REDACTED]

unable to describe fully its purposes and activities, a refusal to issue a ruling or determination letter will be considered an initial adverse determination from which administrative appeal or protest rights will be afforded.

Rev. Proc. 2000-4 I.R.B. 115, sets forth general procedures for the issuance of rulings on issues under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division, which includes rulings relating to recognition of exemption under section 501 of the Code. Section 8.01 of Rev. Proc. 2000-4 provides that the Service ordinarily will not issue a letter ruling or determination letter in certain cases because of the factual nature of the problem involved or because of other reasons. The Service may decline to issue a letter ruling or a determination letter when appropriate in the interest of sound tax administration or on other grounds whenever warranted by the facts and circumstances of a particular case.

The presence of a single nonexempt purpose, if substantial in nature, will preclude exemption under section 501(c)(3) of the Code, regardless of the number or importance of statutorily exempt purposes. Better Business Bureau v. United States, 326 U.S. 279 (1945).

In KJ's Fund Raisers, Inc. v. Commissioner, T.C. Memo 1997-424 (1997), affirmed 82 AFTR 2d 7092 (1998), the Tax Court found that another gaming organization was not exempt. While the organization raised money for charitable purposes, it also operated for the substantial benefit of private interests. The organization's founders, Kristine Hurd and James Gould, were the sole owners of a bar, KJ's Place. The organization, through the owners and employees of KJ's Place, sold lottery tickets exclusively at KJ's Place during regular business hours. While in KJ's Place, the lottery ticket purchasers were sold beverages from the bar. The initial directors were Hurd, Gould, and a related individual. The initial board was replaced several times until Hurd and Gould were no longer on the board. At all times Hurd and Gould were the organization's officers. Salaries had been paid to Hurd and Gould and rent had been paid to KJ's Place. The organization maintained that the fact that salaries and rent were no longer paid in this fashion indicated the independence of the board. The Court took another view.

Although those practices ceased and are not in issue here, the current board of directors is composed of at least the majority of the same members who allowed those amounts to be paid. This strongly suggests that Hurd and Gould are free to set policy for their own benefit without objection from the board. Nothing in the record since July 1, 1994, indicates otherwise.

[REDACTED]

The Court concluded that KJ's Fund Raisers was operated for substantial private benefit and did not qualify for exemption. The Court of Appeals affirmed the decision. It found that the organization had served the private interests of its directors in maintaining and augmenting their business interests.


Traditionally, for the administrative convenience of both the Service and taxpayers, group exemption letters or group rulings have been issued to a parent of subordinates essentially identical in form and function. Examples include fraternal organizations, labor unions, churches, certain youth groups and school organizations. Group exemption may not be appropriate when the activities of the subordinate organization raise questions of whether exempt status is appropriate. The likelihood of private benefit is increased when, as here, subordinates participate in multiple contracts or agreements. If private benefit constitutes a substantial nonexempt purpose a group ruling may be inappropriate.

The information provided raises concerns that your subordinates are operated for private benefit. Your subordinates have the same officers and same formative documents. Each organization is an independent organization. Their board members are members until resignation. There is no restriction on board members receiving compensation. There were no contracts submitted between the different subordinates and the government agencies. No contracts for facilities were provided. Also you provided no contracts with management firms. No information has been provided about your activities and your relationship with the subordinates. You have failed to establish that your subordinates will be operated exclusively for one or more exempt purposes because you have not submitted sufficient information to demonstrate that they will be operated for 501(c)(3) purposes rather than in the interests of private individuals.

As groups rulings are issued at the discretion of the government, we decline to issue a group ruling that recognizes your subordinate entities as organizations described in section 501(c)(3) of the Code due to the complexities involved in determining whether organizations involved in activities governed by different charters and contracts qualify for exempt status. We suggest that your subordinates file form 1023 on an individual basis.

Contributions to your subordinates are not deductible under section 170 of the Code. Your subordinates must file federal income tax returns.

You have the right to protest this ruling on behalf of your subordinates if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request


the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.


If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
T:EO:RA:T:4 Rm. 6236
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,



Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4